Appendix F: Glossary of Terms

GLOSSARY OF TERMS RELATED TO ANGEL INVESTORS, VENTURE CAPITAL AND OTHER PRIVATE EQUITY OR DEBT FINANCINGS

401(K) Plan: A type of qualified retirement plan in which employees make salary-reduced, pre-tax contributions to an employee trust. In many cases, the employer will match employee contributions up to a specified level.

- A -

Accredited Investor: Rule 501 of the SEC regulations defines an individual accredited investor as: "Any natural person whose individual net worth or joint net worth with that person's spouse at the time of his purchase exceeds $1M"; OR "Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year." For the complete definition, see the SEC website.

Accrued Interest: The interest due on preferred stock or a bond since the last interest payment was made.

Accelerated Cost Recovery System ("ACRS" or "Accelerated Depreciation"): The IRS-approved method of calculating depreciation expense for tax purposes.

American Depositary Receipt ("ADR"): A security issued by a U.S. bank in place of the foreign shares held in trust by that bank, thereby facilitating the trading of foreign shares in U.S. markets.

Advisory Board: A group of external advisors to a private equity group or portfolio company. Advice provided varies from overall strategy to portfolio valuation. Less formal than a Board of Directors.

Allocation: The amount of securities assigned to an investor, broker, or underwriter in an offering. An allocation can be equal to or less than the amount indicated by the investor during the subscription process, depending on market demand for the securities.

Amortization: An accounting procedure that gradually reduces the book value of an intangible asset through periodic charges to income.

Alternative Minimum Tax ("AMT"): Tax designed to prevent wealthy investors from using tax shelters to avoid income tax. The calculation of the AMT takes into account tax-preference items.

Angel Financing: Capital raised for a private company from independently wealthy investors; generally used as seed financing.

Angel Group: A formal or informal assemblage of active angel investors who cooperate in some part of the investment process. Key characteristics of an angel group are: control by Member angels (who manage the entity or have control over the entity's managers), and collaboration by Member angels in the investment process.

Angel Investing: An angel investor is an individual who makes direct investments of personal funds into a venture, typically early-stage businesses. Because the capital is being invested at a risky time in a business venture, the angel must be capable of taking a loss of the entire investment, and, as such, most angel investors are high-net-worth individuals. These individuals are nearly always "accredited investors" as defined under the Securities Act of 1933.

Assets Under Management ("AUM"): The amount of capital available to a fund-management team for venture investments.

- B -

Balance Sheet: A condensed financial statement that provides the nature and amount of a company's assets, liabilities and capital.

Bankruptcy: An inability to pay debts. Chapter 11 of the bankruptcy code deals with reorganization, which allows the debtor to remain in business and negotiate for a restructuring of debt.

Bear Hug: An offer made directly to the Board of Directors of a target company. Usually made to increase the pressure on the target with the threat that a tender offer may follow.

Best Efforts: An offering in which the investment banker agrees to distribute as much of the offering as possible and return any unsold shares to the issuer.

Blue Sky Laws: A common term that refers to laws passed by various states to protect the public against securities fraud. The term originated when a judge ruled that a stock had as much value as a patch of blue sky.

Book Value: The Book value of a stock is determined from a company's balance sheet by adding all current and fixed assets and then deducting all debts, other liabilities, and the liquidation price of any preferred issues. The sum arrived at is divided by the number of common shares outstanding, and the result is book value per common share.

Bond: A specific type of debt instrument most commonly sold by government entities.

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Bridge Financing: A limited amount of equity or short-term debt financing typically raised within 6-18 months of an anticipated public offering or private placement meant to "bridge" a company to the next round of financing.

Burn-out/Cram-down: Extraordinary dilution, by reason of a round of financing, of a non-participating investor's percentage ownership in the issuer.

Burn Rate: The rate at which a company expends net cash over a certain period, usually a month.

Business Development Company ("BDC"): A vehicle established by Congress to allow smaller, retail investors to participate in and benefit from investing in small private businesses as well as the revitalization of larger private companies.

Business Judgment Rule: A legal principle that assumes the board of directors is acting in the best interests of the shareholders unless it can be clearly established that it is not. If the board was found to violate the business judgment rule, it would be in violation of its fiduciary duties to the shareholders.

Business Plan: A document that describes the entrepreneur's idea, the market problem, proposed solution, business and revenue models, marketing strategy, technology, company profile, competitive landscape, as well as financial data for coming years. The business plan opens with a brief executive summary, most probably the most important element of the document due to the time constraints of venture capital funds and angels.

- C -

Compound Annual Growth Rate ("CAGR"): The year-over-year growth rate applied to an investment or other aspect of a firm using a base amount.

Call Option: A call option is the right to buy a security at a given price (or range) within a specific time period.

Capital Gains: The difference between an asset's purchase price and selling price, when the selling price is greater. Long-term capital gains (on assets held for a year or longer) are taxed at a lower rate than ordinary income.

Capitalization Table ("Cap Table"): The Cap Table is a table showing the total amount of the various securities issued by a firm. This typically includes the amount of investment obtained from each source and the securities distributed - e.g., common and preferred shares, options, warrants, etc. — and respective capitalization ratios.

Capitalize: To record an outlay as an asset, which is subject to depreciation or amortization.

Carried Interest ("Carry"): Carried interest is the portion of any gains realized by a fund to which the fund managers are entitled. Carried interest payments are customary in the venture capital industry, in order to create a significant economic incentive for venture capital fund managers to achieve capital gains.

Cash Position: The amount of cash available to the company at a given point in time.

Chapter 11: The part of the Bankruptcy Code that provides for reorganization of a bankrupt company's assets.

Chapter 7: The part of the Bankruptcy Code that provides for liquidation of a company's assets.

Claim Dilution: A reduction in the likelihood that one or more of the firm's claimants will be fully repaid, including time value of money considerations.

Clawback: A Clawback obligation represents the general partner's promise that, over the life of the fund, the managers will not receive a greater share of the fund's distributions than they bargained for. Generally, this means that the general partner may not keep distributions representing more than a specified percentage (e.g., 20%) of the fund's cumulative profits, if any. When triggered, the clawback will require that the general partner return to the fund's limited partners an amount equal to what is determined to be "excess" distributions.

Closed-end Fund: A type of fund that has a fixed number of shares outstanding, which are offered during an initial subscription period, similar to an initial public offering. After the subscription period is closed, the shares are traded on an exchange between investors, like a regular stock. The market price of a closed-end fund fluctuates in response to investor demand as well as changes in the values of its holdings or its Net Asset Value. Unlike open-end mutual funds, closed-end funds do not stand ready to issue and redeem shares on a continuous basis.

Closing: An investment event occurring after the required legal documents are implemented between the investor and a company and after the capital is transferred in exchange for company ownership or debt obligation.

Co-investment: The syndication of a private equity financing round or an investment by an individual (usually general partners) alongside a private equity fund in a financing round.

Collar Agreement: A collar agreement is an agreed-upon adjustments in the number of shares offered in a stock-for-stock exchange to account for price fluctuations before the completion of the deal.

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Committed Capital: The total dollar amount of capital pledged to a private equity fund.

Common Stock: Refers to units of ownership of a corporation. In the case of a public company, the stock is traded between investors on various exchanges. Owners of common stock are typically entitled to vote on the selection of directors and other important events and in some cases receive dividends on their holdings. Investors who purchase common stock hope that the stock price will increase so the value of their investment will appreciate. Common stock offers no performance guarantees. Additionally, in the event that a corporation is liquidated, the claims of secured and unsecured creditors and owners of bonds and preferred stock take precedence over the claims of those who own common stock.

Conversion Ratio: Refers to the number of shares of stock into which a Convertible Security may be converted. The conversion ratio equals the par value of the convertible security divided by the conversion price.

Convertible Security: A bond, debenture or preferred stock that is exchangeable for another type of security. Convertibles are appropriate for investors who want higher income, or liquidation-preference protection, than is available from common stock, together with greater appreciation potential than regular bonds offer. (See Common Stock, Dilution, and Preferred Stock).

Convertible Note: A debt instrument that automatically or voluntarily converts to some other security, either debt or equity.

Convertible Preferred Stock: Convertible Preferred Stock is Preferred Stock that may be converted into Common Stock or another class of preferred stock, either voluntarily or mandatory.

Corporate Charter (or "Articles of Incorporation"): The document prepared when a corporation is formed. The Charter sets forth the objectives and goals of the corporation, as well as a complete statement of what the corporation can and cannot do while pursuing these goals.

Corporate Resolution: A document stating that the corporation's board of directors has authorized a particular individual to act on behalf of the corporation.

Corporate Venture Capital: Venture capital provided by the in-house investment funds of large corporations to further their own strategic interests.

Corporation: A legal, taxable entity chartered by a state or the federal government. Ownership of a corporation is held by the stockholders.

Covenant: A protective clause in an agreement.

Cumulative Preferred Stock: A stock having a provision that if one or more dividend payments are omitted, the omitted dividends (arrearage) must be paid before dividends may be paid on the company's common stock.

Cumulative Voting Rights: Refers to the scenario when shareholders have the right to pool their votes to concentrate them on an election of one or more directors rather than apply their votes to the election of all directors. For example, if the company has 12 openings to the Board of Directors, in statutory voting, a shareholder with 10 shares casts 10 votes for each opening (10x12 = 120 votes). Under the cumulative voting method however, a shareholder may opt to cast all 120 votes for one nominee.

- D -

Debenture: A debt instrument; basically the same as a Promissory Note.

Debt: Any obligation by one person to pay another. May be a primary (direct) obligation as in a Note, or a secondary (contingent) obligation as in a guaranty.

Debt Instrument: Any instrument evidencing the obligation of the maker to pay the holder of the debt instrument. Debt includes Bonds, Debentures and Notes of all kinds.

Deficiency Letter: A letter that is sent by the Securities and Exchange Commission to the issuer of a new issue regarding omissions of material fact in the registration statement.

Demand Registration: A resale registration that gives the investor the right to require the Company to file a Registration Statement registering the resale of the securities issued to the investor in a private offering.

Demand Rights: Contemplate that the company must initiate and pursue the registration of a public offering including, although not necessarily limited to, the shares proffered by the requesting shareholder(s).

Depreciation: An expense recorded to reduce the value of a long-term tangible asset. Since it is a non-cash expense, it increases free cash flow while decreasing the amount of a company's reported earnings.

Dilution: A reduction in the percentage ownership of a given shareholder in a company caused by the issuance of new shares.

Dilution Protection: Primarily applicable to Convertible Securities. Standard provision whereby the conversion ratio is changed accordingly in the case of a stock dividend or extraordinary distribution to avoid dilution of a convertible bondholder's potential

equity position. Adjustment usually requires a split or stock dividend in excess of 5% or issuance of stock below book value. Share Purchase Agreements also typically contain anti-dilution provisions to protect investors in the event that a future round of financing occurs at a valuation that is below the valuation of the current round.

Director: An individual elected by shareholders to serve on the Board of Directors. The directors appoint the president, vice president and all other operating officers, and decide when dividends should be paid (among other matters).

Disclosure Document: A booklet outlining the risk factors associated with an investment.

Diversification: The process of spreading investments among various types of securities and various companies in different fields.

Dividend: The payments designated by the Board of Directors to be distributed pro-rata among the shares outstanding. On shares of Preferred Stock, it is generally a fixed amount. On shares of Common Stock, the dividend varies with the fortune of the company and the amount of cash on hand and may be omitted if business is poor or if the Directors determine to withhold earnings to invest in capital expenditures or research and development.

Drag-Along Rights: A majority shareholders' right, obligating shareholders whose shares are bound into the shareholders' agreement to sell their shares into an offer the majority wishes to execute.

Due Diligence: A process undertaken by potential investors - individuals or institutions - to analyze and assess the desirability, value, and potential of an investment opportunity.

- E -

Early Stage: A state of a company that typically has completed its seed stage and has a founding or core senior management team, has proven its concept or completed its beta test, has minimal revenues, and no positive earnings or cash flows.

Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"): A measure of cash flow calculated as Revenue less Expenses (excluding tax, interest, depreciation, and amortization). EBITDA looks at the cash flow of a company. By not including interest, taxes, depreciation, and amortization, we can clearly see the amount of money a company brings in. This is especially useful when one company is considering a takeover of another because the EBITDA would cover any loan payments needed to finance the takeover.

Economies of Scale: The economic principle that, as the volume of production increases, the cost of producing each unit decreases.

Elevator Pitch: An extremely concise presentation of an entrepreneur's idea, business model, company solution, marketing strategy, and competition delivered to potential investors. Should not last more than a few minutes, or the duration of an elevator ride.

Employee Stock Option Plan (ESOP): A plan established by a company whereby a certain number of shares is reserved for purchase and issuance to key employees. Such shares usually vest over a certain period of time to serve as an incentive for employees to build long-term value for the company.

Employee Stock Ownership Plan: A trust fund established by a company to purchase stock on behalf of employees.

Equity: Ownership in the capital of a Company. In corporations, it is called "stock"; in limited partnerships or LLCs, it is called "interests" or "units."

Equity Kicker: Option for private equity investors to purchase shares at a discount. Typically associated with mezzanine financings where a small number of shares or warrants are added to what is primarily a debt financing.

ERISA: The United States Employee Retirement Income Security Act of 1974, as amended, and the regulations promulgated thereunder.

ERISA Significant Participation Test: A test that is satisfied if the General Partner determines in its reasonable discretion that Persons that are "benefit plan investors" within the meaning of Section (f)(2) of the Final Regulation constitute or are expected to constitute at least 25 percent of the interests of the Limited Partners. Note that the test is 25% of the interests of all the limited partners, which means 20% (+/-) in the partnership as a whole, taking into account the general partner's interest.

Exchange Act (the "34 Act"): Regulates periodic reporting by companies with publicly traded securities, companies with more than 500 shareholders, and brokers and dealers in securities.

Exercise price: The price at which an option or warrant can be exercised.

Exit Strategy: A fund's intended method for liquidating its holdings while achieving the maximum possible return. These strategies depend on the exit climates, including market conditions and industry trends. Exit strategies can include selling or distributing the portfolio company's shares after an initial public offering (IPO), a sale of the portfolio company, or a recapitalization.

- F -

Final Regulation: An ERISA term, it is the United States Department of Labor's Final Regulation relating to the definition of "plan assets" in 29 C.F.R. §2510.3-101.

Finder: A person who helps to arrange a transaction.

Flipping: The act of buying shares in an IPO and selling them immediately for a profit. Brokerage firms underwriting new stock issues tend to discourage flipping and will often try to allocate shares to investors who intend to hold on to the shares for some time. However, the temptation to flip a new issue once it has risen in price sharply is too irresistible for many investors who have been allocated shares in a hot issue.

Form 10-K: This is the annual report that most reporting companies file with the Commission. It provides a comprehensive overview of the registrant's business.

Form 10-KSB: This is the annual report filed by reporting "small business issuers." It provides a comprehensive overview of the company's business, although its requirements call for slightly less detailed information than required by Form 10-K.

Form S-1: The form can be used to register securities for which no other form is authorized or prescribed, except securities of foreign governments or political sub-divisions thereof.

Form S-4: Type of Registration Statement under which public company mergers and security exchange offers may be registered with the SEC.

Form SB-2: This form may be used by "small business issuers" to register securities to be sold for cash. This form requires less detailed information about the issuer's business than Form S-1.

Founders' Shares: Shares owned by a company's founders upon its establishment.

Free cash flow: The cash flow of a company available to service the capital structure of the firm. Typically measured as operating cash flow less capital expenditures and tax obligations.

Full Ratchet Anti-Dilution: The sale of a single share at a price less than the favored investors paid reduces the conversion price of the favored investors' convertible preferred stock "to the penny." For example, from $1.00 to $0.50, regardless of the number of lower-priced shares sold.

Fully Diluted Earnings Per Share: Earnings per share expressed as if all outstanding convertible securities and warrants have been exercised.

Fully Diluted Outstanding Shares: The number of shares representing total company ownership, including common shares and current conversion or exercised value of the preferred shares, options, warrants, and other convertible securities.

Fund Size: The total amount of capital committed by the investors of a venture capital or private equity fund.

- G -

Generally Accepted Accounting Principles ("GAAP"): The common set of accounting principles, standards, and procedures. GAAP is a combination of authoritative standards set by standard-setting bodies as well as accepted ways of doing accounting.

General Partner ("GP"): The partner in a limited partnership responsible for all management decisions of the partnership. The GP has a fiduciary responsibility to act for the benefit of the limited partners (LPs) and is fully liable for its actions.

Golden Handcuffs: When an employee is required to relinquish unvested stock when terminating his employment contract early.

Golden Parachute: Employment contract of upper management that provides a large payout upon the occurrence of certain control transactions, such as a certain percentage share purchase by an outside entity or when there is a tender offer for a certain percentage of a company's shares. This is discussed in more detail at the Executive Employment Agreement.

- H -

Holding Company: A corporation that owns the securities of another, in most cases with voting control.

Holding Period: The amount of time an investor has held an investment. The period begins on the date of purchase and ends on the date of sale, and determines whether a gain or loss is considered short term or long term, for capital-gains-tax purposes.

Hot Issue: A newly issued stock that is in great public demand. Technically, it is when the secondary market price on the effective date is above the new issue offering price. Hot issues usually experience a dramatic rise in price at their initial public offering because the market demand outweighs the supply.

Hurdle Rate: The internal rate of return a fund must achieve before its general partners or managers may receive an increased interest in the fund's profits. Often, if the expected rate of return on an investment is below the hurdle rate, the project is not undertaken.

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Appendix F: Glossary of Terms

Initial Public Offering ("IPO"): The sale or distribution of a stock of a portfolio company to the public for the first time. IPOs are often an opportunity for the existing investors (often venture capitalists) to receive significant returns on their original investment. During periods of market downturns or corrections, the opposite is true.

Institutional Investors: Organizations that professionally invest, including insurance companies, depository institutions, pension funds, investment companies, mutual funds, and endowment funds.

Internal Rate of Return (IRR): A typical measure of how VC Funds measure performance. IRR is technically a discount rate: the rate at which the present value of a series of investments is equal to the present value of the returns on those investments.

Investment Company Act of 1940: The Investment Company Act of 1940, as amended, and the rules promulgated thereunder.

Investment Letter: A letter signed by an investor purchasing unregistered securities under Regulation D in which the investor attests to the long-term investment nature of the purchase. These securities must be held for a minimum of one year before they can be sold.

IRA Rollover: The reinvestment of assets received as a lump-sum distribution from a qualified tax-deferred retirement plan. Reinvestment may be the entire lump sum or a portion thereof. If reinvestment is done within 60 days, there are no tax consequences.

Issued Shares: The number of equity securities that a corporation has issued.

Issuer: Refers to the organization issuing or proposing to issue a security.

- K -

Kentucky Windage: In hunting, the modified aim required to compensate for wind or target movement. Used herein to describe the process by which an investor must increase the percentage he needs today so that he will end up with a desired target percentage ownership in the future, after adjusting for future dilutive financing rounds.

Key Employees: Professional management attracted by the founder to run the company. Key employees are typically retained with warrants and ownership of the company.

- L -

Later Stage: A stage of company growth characterized by viable products, a developed market, significant customers, sustained revenue growth, and both profits and positive cash flow from operations.

Lead Investor: Also known as a bell cow investor. Member of a syndicate of private equity investors holding the largest stake, in charge of arranging the financing and most actively involved in the overall project.

Leveraged Buyout ("LBO"): A takeover of a company, using a combination of equity and borrowed funds. Generally, the target company's assets act as the collateral for the loans taken out by the acquiring group. The acquiring group then repays the loan from the cash flow of the acquired company. For example, a group of investors may borrow funds, using the assets of the company as collateral, in order to take over a company. Or the management of the company may use this vehicle as a means to regain control of the company by converting a company from public to private. In most LBOs, public shareholders receive a premium to the market price of the shares.

Limited Partner ("LP"): An investor in a limited partnership who has no voice in the management of the partnership. LPs have limited liability and usually have priority over GPs upon liquidation of the partnership.

Limited Partnerships: An organization comprised of a general partner, who manages a fund, and limited partners, who invest money but have limited liability and are not involved with the day-to-day management of the fund. In the typical venture capital fund, the general partner receives a management fee and a percentage of the profits (or carried interest). The limited partners receive income, capital gains, and tax benefits.

Liquidation: The process of converting securities into cash and/or the sale of the assets of a company to one or more acquirers in order to pay off debts. In the event that a corporation is liquidated, the claims of secured and unsecured creditors and owners of bonds and preferred stock take precedence over the claims of those who own common stock.

Liquidity Event (or "Exit Event"): An event that allows an investor to realize a gain or loss on an investment. The ending of a private equity provider's involvement in a business venture with a view to realizing an internal return on investment. Most common exit routes include IPOs, buy backs, trade sales, and secondary buyouts.

Lock-up Period: The period of time that certain stockholders have agreed to waive their right to sell their shares of a public company. Investment banks that underwrite initial public offerings generally insist upon lockups for a set period of time, typically 180 days from large shareholders (e.g., 1% ownership or more) in order to allow an orderly market to develop in the shares. The shareholders that are subject to lockup usually include the management and directors of the company, strategic partners, and such large investors. These shareholders have typically invested prior to the IPO at a significantly lower price to that offered to the public and therefore

stand to gain considerable profits. If a shareholder attempts to sell shares that are subject to lockup during the lockup period, the transfer agent will not permit the sale to be completed.

- M -

Management Fees: Compensation for the management of a venture fund's activities, paid from the fund to the general partner or investment advisor. This compensation generally includes an annual management fee.

Management Team: The persons who oversee the activities of a venture capital fund.

Market Capitalization: The total dollar value of all outstanding shares. Computed as shares multiplied by current price per share. Prior to an IPO, market capitalization is arrived at by estimating a company's future growth and by comparing a company with similar public or private corporations.

Merger: Combination of two or more corporations in which greater efficiency is supposed to be achieved by the elimination of duplicate plant, equipment, and staff, and the reallocation of capital assets to increase sales and profits in the enlarged company.

Mezzanine Financing: Refers to the stage of venture financing for a company immediately prior to its IPO. Investors entering in this round have lower risk of loss than those investors who have invested in an earlier round. Mezzanine-level financing can take the structure of preferred stock, convertible bonds, or subordinated debt.

Mutual Fund: A mutual fund, or an open-end fund, sells as many shares as investor demand requires. As money flows in, the fund grows. If money flows out of the fund, the number of the fund's outstanding shares drops. Open-ended funds are sometimes closed to new investors, but existing investors can still continue to invest money in the fund. In order to sell shares, an investor usually sells the shares back to the fund. If an investor wishes to buy additional shares in a mutual fund, the investor must buy newly issued shares directly from the fund.

- N -

National Association of Securities Dealers ("NASD"): A mandatory association of brokers and dealers in the over-the-counter securities business. Created by the Maloney Act of 1938, an amendment to the Securities Act of 1934.

NASDAQ: An automated information network that provides brokers and dealers with price quotations on over-the-counter securities.

Net Asset Value ("NAV"): NAV is calculated by adding the value of all of the investments in the fund and dividing by the number of shares of the fund that are outstanding. NAV calculations are required for all mutual funds (or open-end funds) and closed-end funds. The price per share of a closed-end fund will trade at either a premium or a discount to the NAV of that fund, based on market demand. Closed-end funds generally trade at a discount to NAV.

Net Financing Cost: Also called the cost of carry or, simply, carry, the difference between the cost of financing the purchase of an asset and the asset's cash yield. Positive carry means that the yield earned is greater than the financing cost; negative carry means that the financing cost exceeds the yield earned.

Net Income: The net earnings of a corporation after deducting all costs of selling, depreciation, interest expense, and taxes.

Net Present Value ("NPV"): An approach used in capital budgeting where the present value of cash inflow is subtracted from the present value of cash outflows. NPV compares the value of a dollar today versus the value of that same dollar in the future after taking inflation and return into account.

New Issue: A stock or bond offered to the public for the first time. New issues may be initial public offerings by previously private companies or additional stock or bond issues by companies already public. New public offerings are registered with the SEC.

Newco: The typical label for any newly organized company, particularly in the context of a leveraged buyout.

No Shop, No Solicitation Clauses (or "Exclusivity Clause"): A clause that requires the company to negotiate exclusively with the investor, and not solicit an investment proposal from anyone else for a set period of time after the term sheet is signed. The key provision is the length of time set for the exclusivity period.

New York Stock Exchange ("NYSE"): Founded in 1792, the largest organized securities market in the United States. The Exchange itself does not buy, sell, own, or set prices of stocks traded there. The prices are determined by public supply and demand.

- O -

Offering Documents: Documents evidencing a private-placement transaction. Include some combination of a purchase agreement and/or subscription agreement, notes or stock certificates, warrants, registration-rights agreement, stockholder or investment agreement, investor questionnaire, and other documents required by the particular deal.

Open-end Fund: An open-end fund, or a mutual fund, generally sells as many shares as investor demand requires. As money flows in, the fund grows. If money flows out of the fund, the number of the fund's outstanding shares drops. Open-end funds are sometimes closed to new investors, but existing investors can still continue to invest money in the fund. In order to sell shares, an investor

generally sells the shares back to the fund. If an investor wishes to buy additional shares in a mutual fund, the investor generally buys newly issued shares directly from the fund.

Option: A security granting the holder the right to purchase a specified number of a Company's securities at a designated price at some point in the future. The term is generally used in connection with employee benefit plans as Incentive Stock Options ("ISOs" or "statutory options") and Non-qualified stock options ("NSOs" or "Nonquals"). However "stand-alone options" may be issued outside of any plan. Generally, options are non-transferable, in distinction to warrants.

Option Pool: The number of shares set aside for future issuance to employees of a private company.

Over-the-Counter ("OTC"): A market for securities made up of dealers who may or may not be Members of a formal securities exchange. The over-the-counter market is a negotiated market rather than an auction market such as the NYSE.

Outstanding Stock: The amount of common shares of a corporation which are in the hands of investors. It is equal to the amount of issued shares less treasury stock.

Oversubscription: Occurs when demand for shares exceeds the supply or number of shares offered for sale. As a result, the underwriters or investment bankers must allocate the shares among investors. In private placements, this occurs when a deal is in great demand because of the company's growth prospects.

Oversubscription Privilege: An arrangement by which shareholders are given the right to apply for any shares that are not purchased.

- P -

Pari Passu: At an equal rate or pace, without preference.

Participating Preferred: A preferred stock in which the holder is entitled to the stated dividend and also to additional dividends on a specified basis upon payment of dividends to the common stockholders.

Participating Preferred Stock: Preferred stock that has the right to share on a pro-rata basis with any distributions to the common stock upon liquidation, after already receiving the preferred-liquidation preference.

Partnership: A nontaxable entity in which each partner shares in the profits, losses, and liabilities of the partnership. Each partner is responsible for the taxes on its share of profits and losses.

Partnership Agreement: The contract that specifies the compensation and conditions governing the relationship between investors (LPs) and the venture capitalists (GPs) for the duration of a private equity fund's life.

Penny Stocks: Low-priced issues, often highly speculative, selling at less than $5/share.

Piggyback Registration: A situation when a securities underwriter allows existing holdings of shares in a corporation to be sold in combination with an offering of new public shares.

Payment-in-Kind ("PIK") Debt: PIK Debt Securities are bonds that may pay bondholders in a form other than cash.

Placement Agent: The investment bank, broker, or other person that locates investors to purchase securities from the Company in a private offering, in exchange for a commission.

Plain English Handbook: The Securities and Exchange Commission online version of "Plain English Handbook: How to Create Clear SEC Disclosure Documents."

Poison Pill: A right issued by a corporation as a preventative to a takeover measure. It allows right holders to purchase shares in either their company or in the combined target and bidder entity at a substantial discount, usually 50%. This discount may make the takeover prohibitively expensive.

Pooled Investment Vehicle ("PIV"): A legal entity that pools various investors' capital and deploys it according to a specific investment strategy.

Portfolio Companies: Companies in which a given fund has invested.

Post-Money Valuation: The valuation of a company immediately after the most recent round of financing. This value is calculated by multiplying the company's total number of shares by the share price of the latest financing.

Pre-Money Valuation: The valuation of a company prior to a round of investment. This amount is determined by using various calculation models, such as discounted P/E ratios multiplied by periodic earnings, a multiple times a future cash flow discounted to a present cash value and a comparative analysis to comparable public and private companies, or fair market value (FMV).

Preemptive Right: A shareholder's right to acquire an amount of shares in a future offering at current prices per share paid by new investors, whereby his/her percentage ownership remains the same as before the offering.

Preferred Dividend: A dividend ordinarily accruing on preferred shares payable where declared and superior in right of payment to common dividends.

Preferred Stock: A class of capital stock that may pay dividends at a specified rate and that has priority over common stock in the payment of dividends and the liquidation of assets. Many venture capital investments use preferred stock as their investment vehicle.

Private Equity: Equity securities of companies that have not "gone public" (are not listed on a public exchange). Private equities are generally illiquid and thought of as a long-term investment. As they are not listed on an exchange, any investor wishing to sell securities in private companies must find a buyer in the absence of a marketplace. In addition, there are many transfer restrictions on private securities. Investors in private securities generally receive their return through one of three ways: an initial public offering, a sale or merger, or a recapitalization.

Private Investment in Public Equity ("PIPE"): A Private Offering in a Publicly Traded Company; followed by a Resale Registration.

Private Placement (or Private Offering): The sale of a security directly to a limited number of investors in a private transaction. Also known as a Reg. D offering: the sale of unregistered, restricted securities by the company.

Private Placement Memorandum: Also known as an Offering Memorandum, this document outlines the terms of securities to be offered in a private placement. Resembles a business plan in content and structure.

Private Securities: Private securities are securities that are not registered and do not trade on an exchange. The price per share is set through negotiation between the buyer and the seller or issuer.

Promissory Note: Debt instrument in which the maker promises to pay the holder according to its terms.

Prospectus: A formal written offer to sell securities that provides an investor with the necessary information to make an informed decision. A prospectus explains a proposed or existing business enterprise and must disclose any material risks and information according to the securities laws. A prospectus must be filed with the SEC and be given to all potential investors. Companies offering securities, mutual funds, and offerings of other investment companies including Business Development Companies are required to issue prospectuses describing their history, investment philosophy or objectives, risk factors, and financial statements. Investors should carefully read them prior to investing.

Public Company: A company that has securities that have been sold in a registered offering and that are traded on a stock exchange or NASDAQ. Must be a Reporting Company under SEC rules. Often used incorrectly to describe companies that are only Reporting Companies and that have not conducted a registered offering under Securities Act.

Put Option: The right to sell a security at a given price (or range) within a given time period.

- Q -

QPAM: Qualified professional asset manager as defined by ERISA.

- R -

Recapitalization: The reorganization of a company's capital structure. A company may seek to save on taxes by replacing preferred stock with bonds in order to gain interest deductibility. Recapitalization can be an alternative exit strategy for venture capitalists and leveraged-buyout sponsors.

Reconfirmation: The act a broker/dealer makes with an investor to confirm a transaction.

Red Herring: Common name for a preliminary prospectus due to the red SEC required legend on the cover. (See also: Prospectus).

Redeemable Preferred Stock: Redeemable preferred stock, also known as exploding preferred, at the holder's option after (typically) five years, which in turn gives the holders (potentially converting to creditors) leverage to induce the company to arrange a liquidity event. The threat of creditor status can move the founders off the dime if a liquidity event is not occurring with sufficient rapidity.

Registered Offering (or "Public Offering"): A transaction in which a Company sells specified securities to the public under a Registration Statement which has been declared effective by the SEC.

Registration: The SEC's review process of all securities intended to be sold to the public. The SEC requires that a registration statement be filed in conjunction with any public securities offering. This document includes operational and financial information about the company, the management, and the purpose of the offering. The registration statement and the prospectus are often referred to interchangeably. Technically, the SEC does not "approve" the disclosures in prospectuses.

Registration Obligation: The obligation of Company to register the shares issued to an investor in a private offering for resale to the public through a Registration Statement which the SEC has declared effective.

Appendix F: Glossary of Terms

Registration Rights: The right to require that a company register restricted shares. Demand Registration Rights enable the shareholder to request registration at any time, while Piggy Back Registration Rights enable the shareholder to request that the company register his or her shares when the company files a registration statement (for a public offering with the SEC).

Registration Rights Agreement: Separate agreement in which the investor's registration rights are evidenced.

Registration Statement: The document filed by a Company with the SEC under the Securities Act of 1933, as amended, in order to obtain approval to sell the securities described in the Registration Statement to the public. [S-1, S-2, S-3, S-4, SB-1, SB-2, S-8, etc.] Includes the Prospectus.

Regulation A: SEC provision for simplified registration for small issues of securities. A Reg. A issue may require a shorter prospectus and carries lesser liability for directors and officers for misleading statements.

Regulation C: The regulation that outlines registration requirements for Securities Act of 1933.

Regulation D (or "Reg. D"): Regulation D is a "regulation" comprising a series of "rules" promulgated by the SEC that allow for the issuance and sale of securities.

Regulation D Offering: See Private Placement.

Regulation S: The rules relating to Offers and Sales made outside the US without SEC Registration.

Regulation S-B: Reg. S-B of the Securities Act of 1933 governs the Integrated Disclosure System for Small Business Issuers.

Regulation S-K: The standard instructions for filing forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Energy Policy and Conservation Act of 1975.

Regulation S-X: The regulation that governs the requirements for financial statements under the Securities Act of 1933 and the Securities Exchange Act of 1934.

Reporting Company: A company that is registered with the SEC under the Exchange Act.

Resale Registration: Registration by a Company of the investor's sale of the shares purchased by the investor in a private offering.

Restricted Securities: Public securities that are not freely tradable due to SEC regulations.

Restricted Shares: Shares acquired in a private placement are considered restricted shares and may not be sold in a public offering absent registration or after an appropriate holding period has expired. Non-affiliates must wait one year after purchasing the shares, after which time they may sell less than 1% of their outstanding shares each quarter. For affiliates, there is a two-year holding period.

Right of First Refusal ("ROFR"): A ROFR gives the holder the right to meet any other offer before a proposed contract is accepted.

Rights Offering: Issuance of "rights" to current shareholders allowing them to purchase additional shares, usually at a discount to market price. Shareholders who do not exercise these rights are usually diluted by the offering. Rights are often transferable, allowing the holder to sell them on the open market to others who may wish to exercise them. Rights offerings are particularly common to closed-end funds, which cannot otherwise issue additional ordinary shares.

Risk: The chance of losing an investment due to many factors, including inflation, interest rates, default, politics, foreign exchange, call provisions, etc. In Private Equity, known risk factors are outlined in the Risk Factors section of the Placement Memorandum.

Rule 144: Rule 144 provides for the sale of restricted stock and control stock. Filing with the SEC is required prior to selling restricted and control stock, and the number of shares that may be sold is limited.

Rule 144A: A safe-harbor exemption from the registration requirements of Section 5 of the 1933 Act for resales of certain restricted securities to qualified institutional buyers, which are commonly referred to as "QIBs." In particular, Rule 144A affords safe-harbor treatment for reoffers or resales to QIBs - by persons other than issuers - of securities of domestic and foreign issuers that are not listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system. Rule 144A provides that reoffers and resales in compliance with the rule are not "distributions" and that the reseller is therefore not an "underwriter" within the meaning of Section 2(a)(11) of the 1933 Act. If the reseller is not the issuer or a dealer, it can rely on the exemption provided by Section 4(1) of the 1933 Act. If the reseller is a dealer, it can rely on the exemption provided by Section 4(3) of the 1933 Act.

Rule 144A Exchange Offer: A transaction in which one class of securities that were issued in a private placement are exchanged for another, unusually almost identical, class of securities, in a transaction registered with the SEC on a Form S-4 Registration Statement.

Rule 501: Rule 501 of Regulation D defines Accredited Investor, among other definitions and regulations.

Rule 505: Rule 505 of Regulation D is an exemption for limited offers and sales of securities.

Rule 506: Rule 506 of Regulation D is considered a "safe harbor" for the private-offering exemption of Section 4(2) of the Securities Act of 1933. Companies using the Rule 506 exemption can raise an unlimited amount of money if they meet certain exemptions.

- S -

SBIR/STTR: Small Business Innovation Research Program / Small Business Technology Transfer Program. See Small Business Innovation Development Act of 1982.

Secondary Sale: The sale of private or restricted holdings in a portfolio company to other investors.

Securities: Includes all types of equity and debt instruments and rights in and to them.

Securities Act of 1933: The federal law covering new issuances of securities. It provides for full disclosure of pertinent information relating to the new issue and also contains antifraud provisions.

Securities Act of 1934: The federal law that established the Securities and Exchange Commission. The act outlaws misrepresentation, manipulation, and other abusive practices in the issuance of securities.

Securities and Exchange Commission (or SEC): The SEC is an independent, nonpartisan, quasi-judicial regulatory agency that is responsible for administering the federal securities laws. These laws protect investors in securities markets and ensure that investors have access to all material information concerning publicly traded securities. Additionally, the SEC regulates firms that trade securities, people who provide investment advice, and investment companies.

Seed Money: The first round of capital for a start-up business. Seed money usually takes the structure of a loan or an investment in preferred stock or convertible bonds, although sometimes it is common stock. Seed money provides startup companies with the capital required for their initial development and growth. Angel investors and early-stage venture capital funds often provide seed money.

Seed Stage Financing: An initial state of a company's growth characterized by a founding management team, business-plan development, prototype development, and beta testing.

Senior Securities: Securities that have a preferential claim over common stock on a company's earnings and in the case of liquidation. Generally, preferred stock and bonds are considered senior securities.

Series A Preferred Stock: The first round of stock offered during the seed or early-stage round by a portfolio company to the venture investor or fund. This stock is convertible into common stock in certain cases such as an IPO or the sale of the company. Later rounds of preferred stock in a private company are called Series B, Series C, and so on.

Shell Corporation (or Specified Purpose Acquisition Company ("SPAC")): A corporation with no assets and no business. Typically, shell corporations are designed for the purpose of going public and later acquiring existing businesses.

Small Business Administration ("SBA"): Provides loans to small-business investment companies (SBICs) that supply venture capital and financing to small businesses.

Small Business Innovation Development Act of 1982: The Small Business Innovation Research (SBIR) program is a set-aside program for domestic small-business concerns to engage in Research/Research and Development (R/R&D) that has the potential for commercialization. Established under the Small Business Innovation Development Act of 1982; reauthorized for a second time until September 30, 2008 by the Small Business Reauthorization Act of 2000.

Staggered Board: This is an anti-takeover measure in which the election of the directors is split in separate periods so that only a percentage (e.g., one-third) of the total number of directors come up for election in a given year. It is designed to make taking control of the board of directors more difficult.

Statutory Voting: A method of voting for Members of the Board of Directors of a corporation. Under this method, a shareholder receives one vote for each share and may cast those votes for each of the directorships. For example: An individual owning 100 shares of stock of a corporation that is electing six directors could cast 100 votes for each of the six candidates. This method tends to favor the larger shareholders.

Stock Options: A stock option is the right to purchase or sell a stock at a specified price within a stated period. Options are a popular investment medium, offering an opportunity to hedge positions in other securities, to speculate on stocks with relatively little investment, and to capitalize on changes in the market value of options contracts themselves through a variety of options strategies. Stock options are also a widely used form of employee incentive and compensation: the employee is given an option to purchase its shares at a certain price (at or below the market price at the time the option is granted) for a specified period of years.

Strategic Investors: Corporate or individual investors that add value to investments they make through industry and personal ties that can assist companies in raising additional capital as well as provide assistance in the marketing and sales process.

Subscription Agreement: The application submitted by an investor wishing to join a limited partnership. All prospective investors must be approved by the General Partner prior to admission as a partner.

Subordinated Debt or Note: Debt which by its terms has no right to be paid until another debt holder is paid. Also referred to as "junior" debt.

Syndicate: Underwriters or broker/dealers who sell a security as a group.

- T -

Tag-Along Rights/Rights of Co-Sale: A minority-shareholder protection affording the right to include their shares in any sale of control and at the offered price.

Takedown Schedule: A takedown schedule means the timing and size of the capital contributions from the limited partners of a venture fund.

Tax-free Reorganizations: Types of business combinations in which shareholders do not incur tax liabilities. There are four types (A, B, C, and D reorganizations) that differ in various ways in the amount of stock/cash that can be offered.

Tender Offer: An offer to purchase stock made directly to the shareholders.

Term Sheet: A summary of the terms the investor is prepared to accept. A non-binding outline of the principal points which the Stock Purchase Agreement and related agreements will cover in detail.

Time Value of Money: The basic principle that money can earn interest; therefore, something that is worth $1 today will be worth more in the future if invested. This is also referred to as future value.

Treasury Stock: Stock issued by a company but later reacquired. It may be held in the company's treasury indefinitely, reissued to the public, or retired. Treasury stock receives no dividends and does not carry voting power while held by the company.

Trust Indenture: Agreement between the Company, the debt holders, and the trustee for the debt holders. Required for registered offerings of debt securities. See also: Trust Indenture Act of 1939.

- U -

ULPA: Uniform Limited Partnership Act, see also the RULPA, Revised Uniform Limited Partnership Act U.L.P.A. § 101 et seq. (1976), as amended in 1985 (R.U.L.P.A.).

Unaccredited Investor: An investor that is not considered an Accredited Investor for the purposes of a Regulation D offering.

Underwriter: The "underwriters" are the investment banks selling the securities in an underwritten registered offering. But beware, under the Securities Act, the class of persons who are considered "underwriters" is far more expansive and problematic.

Underwritten Offering: Registered offering that is sold through a consortium of investment banks assembled by one or more lead investment banks.

Unit Offering: Private or public offering of securities in groups of more than one security. Most often a share of stock and warrant to purchase some number of shares of stock, but could be two shares of stock, a note and a share of stock, etc. Also used in some cases to refer to the sale of LP and LLC interests, since those interests are composed of more than one right.

- V -

Venture Capital Financing: An investment in a startup business that is perceived to have excellent growth prospects but does not have access to capital markets. Type of financing sought by early-stage companies seeking to grow rapidly.

Voting Right: The common stockholders' right to vote their stock in the affairs of the company. Preferred stock usually has the right to vote when preferred dividends are in default for a specified amount of time. The right to vote may be delegated by the stockholder to another person.

- W -

Warrant: A type of security that entitles the holder to buy a proportionate amount of common stock or preferred stock at a specified price for a period of years. Warrants are usually issued together with a loan, a bond, or preferred stock and act as sweeteners, to enhance the marketability of the accompanying securities. They are also known as stock-purchase warrants and subscription warrants.

Weighted Average Anti-dilution: The investor's conversion price is reduced, and thus the number of common shares received on conversion increased, in the case of a down round; it takes into account both: (a) the reduced price and, (b) how many shares (or rights) are issued in the dilutive financing.

Williams Act of 1968: An amendment of the Securities and Exchange Act of 1934 that regulates tender offers and other takeover-related actions such as larger share purchases.

Workout: A negotiated agreement between the debtor and its creditors outside the bankruptcy process.

Write-off: The act of changing the value of an asset to an expense or a loss. A write-off is used to reduce or eliminate the value of an asset and reduce profits.

Write-up/Write-down: An upward or downward adjustment of the value of an asset for accounting and reporting purposes. These adjustments are estimates and tend to be subjective, although they are usually based on events affecting the investee company or its securities beneficially or detrimentally.